

Decision 04-06-017 June 9, 2004

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation into NOS COMMUNICATIONS, INC. (U-5251-C), dba International Plus, 011 Communications, Internet Business Association (INETBA), I-Vantage Network Solutions; AFFINITY NETWORK, INC. (U-5229-C), dba QuantumLink Communications and HorizonOne Communications; and the corporate officers of NOS and ANI, to determine whether they have violated the laws, rules, and regulations governing the manner in which California subscribers are solicited, switched from one presubscribed carrier to another, and billed for telephone services.

Investigation 02-05-001
(Filed May 2, 2002)

In the Matter of the Application of Blue Ridge Telecom Systems, LLC for a Certificate of Public Convenience and Necessity to Provide Facilities-Based and Resold Local Exchange Services Within California.

Application 01-12-013
(Filed December 10, 2001)

FINAL OPINION APPROVING SETTLEMENT AGREEMENT

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FINAL OPINION APPROVING SETTLEMENT AGREEMENT

Summary

In this decision, we approve with modifications a settlement agreement entered into between the Commission's Consumer Protection and Safety Division (CPSD) and certain of the respondents in this proceeding. The settlement agreement was filed on December 9, 2003, and is appended hereto as Attachment A.

Under the settlement agreement, the respondents will make payments to the Commission over a 24-month period totaling \$2,950,000. Of this sum, \$2,900,000 will be deposited into the State's General Fund, and \$50,000 will be set aside for customer restitution. Each of about 1400 customers will receive a restitution payment of \$25, and \$7,825 of the \$50,000 will be used to compensate the settlement claims administrator, Rosenthal & Company LLC (Rosenthal), that CPSD and the respondents have agreed will handle the actual notification of customers and payment of restitution.

The settlement agreement also requires that for a two-year period after approval of the settlement, respondents will abide by the "Call Unit Marketing and Sales Compliance Program" that is an integral part of the settlement and consent decree that respondents entered into with the Federal Communications Commission (FCC) in December 2002.¹

Finally, CPSD has agreed to withdraw its protest of Application (A.) 01-12-013, in which Blue Ridge Telecom Systems, LLC (Blue Ridge)—a

¹ *NOS Communications, Inc. and Affinity Network Incorporated*, Order, File No. EB-00-TC-005, 17 FCC Rcd 26853 (December 26, 2002). Hereinafter, this will be referred to as the "FCC TCU Consent Decree."

company controlled by the same individuals who control respondents NOS Communications, Inc. (NOS) and Affinity Network, Inc. (ANI)—seeks a certificate of public convenience and necessity (CPCN) to operate as a facilities-based reseller of local exchange services in California. CPSD has agreed to withdraw its protest of A.01-12-013 within 30 days after issuance of a Commission decision approving the settlement agreement, so that Blue Ridge’s application can be “resolve[d] . . . as an unopposed application.”

Applying the standards of Rule 51.1(e) of our Rules of Practice and Procedure (Rules), we find that with certain modifications, the settlement agreement is reasonable in light of the whole record, consistent with law, and in the public interest, and should therefore be approved. In particular, although we agree that CPSD should be allowed to withdraw its protest of A.01-12-013, we will require the respondents to submit a supplement to that application, and authorize the Administrative Law Judge (ALJ) assigned to A.01-12-013 to hold a hearing on the fitness of the applicants if the ALJ deems such a hearing to be necessary.

Procedural Background

The Order Instituting Investigation (OII) in this matter alleged that respondents NOS and ANI, both of which hold CPCNs from this Commission, had engaged in deceptive marketing, slamming, and cramming, all of which constitute violations of the Public Utilities Code. The OII generally alleged that respondents engaged in this unlawful conduct through the following means:

“They solicit new customers, primarily small and medium size businesses, by telemarketing. Respondents’ telemarketers represent that telephone service will be charged on a per minute usage basis. However, customers are subsequently charged according to a ‘Total Call Unit’ (TCU) pricing methodology that consists of usage and non-usage charges and [is] not based on cents per minute usage.

Determining the TCU charges requires a conversion calculation that few, if any, customers can understand.” (OII, p. 2.)

The OII noted that since 1999, the Commission’s Consumer Affairs Branch (CAB) had received over 850 consumer complaints involving NOS or ANI, most of which concerned deceptive marketing, cramming or slamming based on the use of the TCU methodology. The OII noted that while NOS and ANI claimed their telemarketers disclosed the general terms of the TCU methodology during telemarketing, the complaining consumers contended otherwise:

“Consumers consistently express surprise when they discover their telephone billings are based on TCUs and exceed the per minute usage rates promised by the Respondents’ telemarketing. Consumers complain that they were not informed of the TCUs before they switched to the Respondents and never authorized the TCUs. Those who have reviewed the Respondents’ explanations of the TCU, find it so complicated and indecipherable as to amount to no disclosure or an apparent effort to deceive, hide, or misrepresent the Respondents’ excessive rates.” (*Id.* at 3.)

In addition to respondents’ failure to disclose the terms of the TCU methodology, the OII noted that some customers had complained that after they canceled their service with NOS and ANI, they were subjected to early termination penalties and the re-rating of international calls at much higher rates than those promised by respondents’ telemarketers. The OII also pointed out that respondents had been the subject of enforcement actions and lawsuits in several states because of the TCU methodology, and that the FCC had issued a Notice of Apparent Liability for Forfeiture against respondents due to the TCU.

The OII concluded that respondents’ conduct appeared to violate Pub. Util. Code § 2889.5, which requires telephone corporations and their agents to “thoroughly inform the subscriber of the nature and extent of the service being offered.” The OII also alleged that the conduct of respondents’ telemarketers in

failing to disclose and obtain customer consent to TCU pricing, call re-rating, early termination penalties, etc., should also be deemed to constitute cramming in violation of Pub. Util. Code § 2890. (*Id.* at 6.)

In addition to making NOS, ANI, and the officers of these carriers respondents in the proceeding, the OII directed them to provide the Commission's Consumer Services Division (CSD) with answers to certain data requests within 30 days. The OII expressly provided that CSD could continue its discovery, and would also be permitted to file motions to raise additional charges or additional respondents.

The first prehearing conference (PHC) in this matter was held on June 21, 2002. The first item of business was to rule on an emergency motion for a protective order filed by NOS and ANI, which sought to impose significant restrictions on the use of billing and other customer information that the OII had required be produced for CSD. The assigned ALJ denied the motion after noting assurances from CSD's counsel that the information at issue would be treated confidentially, unless a ruling permitting public disclosure was first obtained.

The ALJ then asked for a status report on the other litigation pending against NOS and ANI, and in particular on the status of the proceedings before the FCC. Respondents' counsel agreed to provide a copy of the NOS and ANI response filed at the FCC, and to provide respondents' settlement agreement with the Florida Attorney General to the extent it was a public document.

There was also some discussion of how soon CSD expected to be able to complete its discovery and finalize the allegations and parties in the OII. After CSD counsel stated that it would probably take three to four months, and that time would also be needed to produce CAB's consumer complaint files for respondents, respondents' counsel expressed frustration that the possibility of additional allegations made the OII a "moving target." Rather than ruling on

how many rounds of testimony would be allowed, or setting cut-off dates for raising additional allegations, the ALJ decided to defer such rulings and require the parties to submit status reports on their progress in completing discovery and preparing for hearing.

The final topic at the PHC was a series of motions that respondents' counsel proposed to file to address alleged jurisdictional defects in the OII. The first was a motion already filed on May 30, 2002 that challenged the propriety of naming the individual officers of NOS and ANI as respondents. The second was a motion (which, as noted below, was filed shortly after the PHC) challenging the Commission's assertion of jurisdiction over international telephone services, an action that respondents argued was barred by the "filed rate" doctrine and by federal preemption principles. The third motion concerned the extent of the Commission's power to impose fines and reparations, and whether the sanctions sought in the OII really amounted to an impermissible award of damages.

After some discussion of when these motions would be filed, the ALJ directed the parties to file two status reports. The first was to deal with CSD's progress in providing the CAB's consumer complaint files to respondents. The second was to deal with CSD's progress in completing its investigation and deciding whether to file a motion to add new allegations to the OII.²

² As ordered, the parties submitted their status reports on July 8 and July 24, 2002. In its July 8 report, CPSD, successor to CSD, stated that it had provided respondents with approximately 45% of the CAB's complaint files involving NOS and/or ANI, and that it would take up to three more months to locate, copy, and deliver the remainder of the files to respondents' counsel. Respondents' report confirmed these figures.

In the second status report on July 24, CPSD stated that it had provided respondents with a few additional files, and reiterated that it would take three more months (until late October 2002) to complete discovery and prepare supplemental declarations.

Footnote continued on next page

In accordance with their representations at the PHC, the respondents did file two additional motions going to the scope of the OII. On June 28, 2002, respondents filed a motion to dismiss “any and all claims or causes of action” related to the provision of international telephone services. The motion was based on two grounds. First, respondents asserted that the services in question were subject to exclusive federal jurisdiction. Second, respondents contended that their charges were consistent with federal tariffs on file at the FCC, and that under such cases as *American Telephone & Telegraph Co. v. Central Office Telephone, Inc.*, 524 U.S. 214 (1998) and *Cahnmann v. Sprint Corp.*, 133 F.3d 484 (7th Cir. 1998), their marketing practices were immune from a Commission challenge under the federal filed rate doctrine.³

On July 15, 2002, respondents also filed a motion contending that under Pub. Util. Code § 2017, the Commission lacked authority to impose fines for violations of Pub. Util. Code §§ 2889.5 and 2890, the principal provisions relied on in the OII. Moreover, respondents continued, since the Commission clearly lacked authority to award damages, it could not circumvent this limitation by characterizing as “reparations” what was really a claim for damages.⁴

Respondents’ second status report stated that there was no need for a meet-and-confer session with CPSD about outstanding discovery requests.

³ In its response to the motion, CPSD argued that respondents’ international calling services were an “integral part” of their operations, and that under such decisions as *Day v. AT&T Corp.*, 63 Cal.App.4th 325 (1998) and *Pink Dot, Inc. v. Teleport Communications Group*, 89 Cal.App.4th 407 (2001), the federal filed rate doctrine does not act as a bar to state law claims for deceptive marketing, cramming, and slamming of the kind asserted in the OII.

⁴ On July 30, 2002, CPSD filed a response arguing, *inter alia*, that under D.97-10-063 and other cases, the Commission has authority to impose fines for violations of Pub. Util. Code §§ 2889.5 and 2890.

There were no further filings or rulings in this case during the remainder of 2002 or the first quarter of 2003. On April 17, 2003, the Commission issued Decision (D.) 03-04-053, which extended the 12-month deadline for the proceeding pursuant to Pub. Util. Code § 1701.2(d). After reciting the procedural history set forth above and concluding that the 12-month deadline could not be met, the Commission stated that “the appropriate course of action is to extend the 12-month deadline and take steps to ensure that this proceeding is either brought to hearing or settled within a reasonable period of time.” (*Mimeo.* at 9.)

Accordingly, D.03-04-053 instructed the ALJ to hold a PHC within 90 days, at which he was to set a deadline for the submission of supplemental testimony (in the event that the discovery conducted by CPSD was complete), or to set deadlines for the completion of this discovery and the filing of any motion to amend the OII. The decision also directed the ALJ to rule on the three pending motions, unless the parties were able to reach a settlement in the meantime. (*Id.*) Finally, the decision pointed out that in December 2002, the FCC had adopted a consent decree pursuant to which NOS and ANI agreed to abide by various restrictions on their TCU telemarketing and training practices, and to make a voluntary payment to the FCC of \$1,000,000. In exchange, the FCC agreed to terminate the enforcement proceeding it had commenced against NOS and ANI in April 2001.

The required PHC was held on June 20, 2003. The ALJ began by noting that after the issuance of D.03-04-053, CPSD had submitted 17 volumes of additional material relating to the allegations in the OII, as well as a motion to add NOSVA Limited Partnership (NOSVA) as a respondent. (PHC Transcript, pp. 66-67.) The ALJ stated that although he was inclined to grant this motion, it might not be necessary to act on it if—as the parties’ PHC statements suggested—there was a realistic hope of settlement. Both CPSD counsel and

respondents' counsel confirmed that they had made progress in settlement discussions, and that they were hopeful of reaching a settlement in the near future. (*Id.* at 69-71.) After an off-the-record discussion about the three motions by respondents discussed at the June 21, 2002 PHC, the ALJ ruled that the parties should advise him by July 21, 2003 whether they had been able to reach a settlement. In the event they had not, another PHC would be held on July 28, 2003 to set a hearing schedule. (*Id.* at 73, 76.)⁵

Because the parties were unable to reach a settlement by July 21, another PHC was held on July 28, 2003. After an extensive off-the-record discussion, the parties agreed on a schedule under which both parties would finish taking depositions by October 15, the respondents' testimony would be due on November 14, 2003, and hearings would be held from January 12 to 23, 2004.

This schedule became moot when CPSD informed the ALJ on August 8, 2003 that it had reached a settlement with respondents. On December 9, 2003, the parties filed a joint motion seeking Commission approval of the settlement agreement appended to this decision as Attachment A.⁶ No party has opposed the proposed settlement agreement.

⁵ After the off-the-record discussion, the ALJ also ruled that apart from its motion to add NOSVA as a respondent, CPSD would not be allowed to seek further amendments to the OIL, and that staff would be permitted to offer evidence of consumer complaints only as to those cases in which the CAB's complaint file had been produced for respondents' counsel. (*Id.* at 74.)

⁶ The 10-page settlement agreement in Attachment A consists of a description of the parties, a "summary/joint statement of the case," and then nine numbered sections. In addition, three appendices designated A through C are attached to the settlement agreement. Unless otherwise specified, references to paragraph numbers in this decision are to the numbered paragraphs that appear under each of the nine numbered sections in the settlement agreement.

Terms of the Proposed Settlement

The proposed settlement has five parts. The first calls for the respondents⁷ to make payments to the Commission totaling \$2,950,000 over a 24-month period. The second part requires \$50,000 of this total to be set aside to pay restitution, with approximately \$35,000 being paid to eligible customers and \$7,825 going to Rosenthal, the settlement claims administrator, as its fee.

Third, the settlement agreement provides that for a two-year period following its approval by the Commission, the named respondents will abide by the “Call Unit Marketing and Sales Compliance Program” included in the FCC TCU Consent Decree. Fourth, respondents have agreed that if their FCC operating authority is revoked as a result of the Order to Show Cause issued by the FCC in April 2003 in connection with respondents’ “Winback Campaign,”⁸ they will relinquish the CPCNs granted to them by this Commission and cease

⁷ The settlement agreement states that the respondents entering into it are NOS, ANI, and NOSVA. No mention is made of Michael Arnau, Joseph Koppy, Kenneth Kirkpatrick or Robert Lichtenstein, each of whom was identified in the OII as an officer of NOS and/or ANI and made an individual respondent. (OII, p. 2.) Nor does the settlement agreement refer to the fact that in D.02-07-045, the decision denying rehearing of the OII, we ruled that Blue Ridge would be considered a party in this investigation.

Despite these omissions, it appears that the parties’ intent is that this proceeding should be terminated as to both the individual respondents and Blue Ridge. In the case of Messrs. Arnau, Koppy, Kirkpatrick and Lichtenstein, this seems clear from the May 30, 2002 motion to dismiss them as individual respondents. In the case of Blue Ridge, the parties’ intent seems clear from the provisions in the settlement agreement contemplating that Blue Ridge’s pending application, A.01-12-013, will be resolved.

⁸ *NOS Communications, Inc., Affinity Network Incorporated and NOSVA Limited Partnership*, Order to Show Cause and Notice of Opportunity for Hearing, EB Docket No. 03-96, 18 FCC Rcd 6952 (April 7, 2003). Hereinafter, this will be referred to as the “Winback Order to Show Cause.”

operating as telephone corporations within California. Finally, if the settlement agreement is approved, CPSD agrees to withdraw its protest in A.01-12-013 so that Blue Ridge's application to provide facilities-based and resold competitive local exchange services in California can be resolved as an "unopposed application." The settlement agreement also provides that in consideration of the parties' acceptance of these terms, "the Commission agrees to end its investigation and close the docket in I.02-05-001," and that "by agreeing to this Settlement, the Respondents admit no fact, law, or violation." We will discuss these provisions in turn.

As to payment of the settlement sum, the agreement provides that within 45 days after the Commission's decision approving the settlement, respondents will furnish two checks: one for \$500,000 payable to the Commission (for deposit into the General Fund), and a second for \$50,000 payable to Rosenthal. (§1.2.) Within each three-month period following this initial payment, the respondents agree to deliver another check payable to the Commission in the amount of \$300,000, "until the Respondents' installment payments to the Commission accumulate to \$2.95 million." (§1.3.)⁹ The agreement also provides that the respondents waive any "potential, residual, or current" claim or interest to any of the settlement funds, "except if this Settlement is rescinded or its approval by the Commission [is] vacated." (§1.4.) Upon payment of the full \$2.95 million, the respondents will be released from liability for "all costs, direct or indirect,

⁹ In addition to their payment obligations, the respondents agree that within 10 days after issuance of a Commission decision approving the settlement, they will "cease or cause to cease . . . all billing, collecting, or demand for payment of any telephone billing, service fee, or outstanding balance that resulted from or was caused by" any of the unlawful conduct alleged in the OII. (§3.4.)

presently known or unknown, accruing to or incurred by the Commission” in connection with this investigatory proceeding. (§5.2.)

Many provisions in the settlement agreement concern the settlement claims process and the duties of Rosenthal. First, respondents agree to execute the fee agreement with Rosenthal within the same 45-day period in which they must deliver their first two checks to the Commission.¹⁰ (§2.1.) Rosenthal agrees to establish an escrow account into which the \$50,000 check will be deposited, to segregate the amount representing its fee, and to inform CPSD that the account is open and that the restitution process can proceed. (§2.2.) Within 10 days after such notification, CPSD agrees to furnish Rosenthal with the name, address, telephone billing number and other appropriate data for each of the approximately 1400 customers who are considered “Eligible Consumers” entitled to a restitution payment.¹¹ (§2.3.) Within 30 days after receipt of this data from CPSD, Rosenthal is obliged to distribute the restitution checks (each in the amount of \$25) to the Eligible Consumers, along with an explanatory statement from CPSD. (§§2.4, 3.2.)

¹⁰ The fee agreement attached as Appendix A to the settlement agreement provides that Rosenthal in its capacity as settlement claims administrator “will serve as the fiduciary of the Eligible Consumers in establishing, managing, and controlling the Restitution Escrow Account.”

¹¹ §8.12 defines an “Eligible Consumer” as a California customer of one of the respondents who made a complaint to CAB between January 1, 1999 and the date on which the Commission issues its decision approving the settlement, with respect to one or more of the following issues: “the Respondents or its agents switched or caused the LEC to switch without authorization the consumer’s presubscribed local, toll or long distance telephone service provider to the Respondents; charged the consumer without authorization for telephone services; or engaged in abusive marketing operations or practices.”

There is a time limit on the restitution checks. They expire 90 days after the date printed on the check, and if a check is undeliverable or the Eligible Consumer fails to deposit or cash the check within the 90-day period, Rosenthal “will cancel the Restitution Check and attempt no redelivery.” (§3.3.) The settlement agreement also provides that within 130 days after the last restitution check is mailed, Rosenthal will pay the amount representing uncashed checks to the Commission. (§4.1.)

As a corollary of this obligation, Rosenthal is obliged to furnish the Commission with a final report covering its work from the date the escrow account is established until the time the restitution process is complete. Rosenthal’s report is to set forth the balance in the escrow account for each month from the time it is opened, and to report by month on the number of restitution checks that (1) have been mailed, deposited or cashed, (2) have expired, or (3) have been returned as undeliverable. (§4.2.)

As noted above, the third major part of the settlement is an agreement that for two years following its approval by this Commission, the respondents will abide by the “Call Unit Marketing and Sales Compliance Program” included in the FCC TCU Consent Decree. (§6.1.) Under this program,¹² the respondents agreed with the FCC to undertake a variety of measures designed to ensure that the abuses associated with the marketing and billing of the TCU program would not recur.

The FCC compliance program requires, among other things, that (1) the compliance program must be reviewed and implemented by legal counsel

¹² The full text of the Call Unit Marketing and Sales Compliance Program is set forth in Part IV of the FCC TCU Consent Decree, and is published at 17 FCC Rcd 26861-26863.

knowledgeable in both consumer protection and telecommunications law, (2) such counsel must also review, edit, and approve all materials used for marketing, advertising, or training in connection with the TCU methodology, and (3) all officers and directors, and all managers and employees involved with marketing and customer service, must be informed of the FCC consent decree and furnished with written instructions regarding their responsibilities for implementing it. In addition to these requirements, all marketing management personnel must receive annual training on the TCU compliance program and a related code of conduct (which all marketing employees must sign), and the respondents are obliged to take appropriate disciplinary action against any employee or agent found to have engaged in intentionally deceptive conduct in marketing or selling any TCU program.

As previously stated, the fourth major component of the settlement is an agreement by respondents that in the event their FCC operating authority is revoked as a result of the Winback Order to Show Cause issued on April 7, 2003, they will surrender the CPCNs granted to them by this Commission and cease doing business as telephone corporations in California. (§6.2.)

The Winback Order to Show Cause dealt with respondents' so-called Winback Campaign, a marketing campaign that the Order to Show Cause characterized as "an apparently misleading scheme to trick consumers into returning to the Companies' services."¹³ However, this FCC proceeding has not

¹³ In the Winback Order to Show Cause, the FCC gave the following description of how the Winback Campaign allegedly worked:

"[I]t appears that NOS/ANI may have willfully or repeatedly violated section[] 201(b) of the Communications Act of 1934 . . . by conducting a

Footnote continued on next page

resulted in the revocation of any FCC operating authority, because on October 29, 2003, the ALJ assigned to the matter issued an order approving a consent decree (Winback Consent Decree) entered into by the respondents and the FCC's Enforcement Bureau.¹⁴ Under the Winback Consent Decree, the respondents (1) have agreed to stop engaging in specific practices that were alleged to be misleading in the context of the Winback Campaign, (2) have agreed to adopt a special code of conduct dealing with attempts to win back customers, and (3) have agreed to engage in an extensive training program for all current and future employees involved with Winback efforts, including all

misleading marketing campaign (the 'Winback Campaign') apparently designed to improperly induce former customers into authorizing switches back to NOS/ANI. These improper inducements apparently included the Companies contacting their former customers and describing 'problems' that the customers' chosen carriers were allegedly having in completing the customers' requests to establish new service. NOS/ANI apparently threatened their former customers with loss of service unless they agreed to retain NOS/ANI services as a 'temporary measure.' Under coercion, some of these customers signed Letters of Agency ('LOAs') that authorized the Companies to be their preferred carriers, believing that doing so was necessary to keep receiving service while their new preferred carriers completed their switches. The representations of NOS/ANI to their former customers appear to be knowingly false. In reality, the consumers had already been switched to their new preferred carriers and the Companies' marketing campaign was an apparently misleading scheme to trick consumers into returning to the Companies' services." (Winback Order to Show Cause ¶2, 18 FCC Rcd at 6953.)

¹⁴ The FCC ALJ's order adopting the consent decree has apparently not been published. However, it can be found by going to the FCC's Website, <http://www.fcc.gov>, and clicking on "Enforcement" under Bureaus, "Orders," and then typing "NOS Communications" into the search window.

telemarketing representatives, managers, supervisors, and agents.¹⁵ In addition to these obligations, and in consideration of the FCC's agreement to close the

¹⁵ Many of the obligations undertaken by the respondents appear in paragraphs 9 and 10 of the Winback Consent Decree, which is attached to the FCC ALJ's October 29, 2003 order. For example, paragraph 9(b) states:

"Beginning on the Effective Date, no Winback Call will represent, suggest or imply information that:

- (i) the Customer will need to take action to avoid having service immediately disrupted;
- (ii) the Customer needs to sign a LOA to prevent the termination or disruption of service over any lines still billing with the Companies;
- (iii) an LOA is temporary;
- (iv) the Winback Call is a courtesy call;
- (v) the Winback Representative is not a sales person;
- (vi) a new LOA is required to carry a Customer's service during the interim period while a Customer's lines are being switched to a new carrier;
- (vii) the Winback Representative is calling from the cancel department or that the Winback Representative's job is to cancel accounts or take-down service;
- (viii) the Customer's request to switch carriers voids the Companies' authorization to carry the Customer's lines during the period it takes the new carrier to initiate and complete a customer requested switch;
- (ix) the Companies have a tariff on file with the FCC;
- (x) the FCC will hold the Companies liable for slamming if the Customer fails to sign an LOA to authorize the Companies to carry the Customer's service during the period it takes a new carrier to initiate and complete a Customer requested switch; or

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Winback Order to Show Cause proceeding, the respondents have agreed to make a “voluntary contribution” of \$1.2 million to the U.S. Treasury.¹⁶

As noted above, the final part of the settlement agreement that CPSD and respondents have negotiated is an undertaking by CPSD to withdraw the protest it filed on February 8, 2002 in connection with A.01-12-013, Blue Ridge’s application to provide facilities-based and resold local exchange services in California. The key provision of the settlement agreement on this issue is ¶5.10, which states in full:

“Within 30 days after the Issuance Date [of the Commission decision approving the settlement,] CPSD will file with the Commission a withdrawal of its presently pending protest to A.01-12-013 regarding Blue Ridge. CPSD agrees that it will not protest an application filed by Respondents or any of their affiliates pursuant to Sections 851-854, 1001, or 1013 based on the investigation or allegations in this matter.”

Other provisions in the settlement address such things as cooperation with law enforcement agencies and the effect of any changes the Commission might order in the settlement agreement. For example, while CPSD has agreed that it will “initiate no enforcement action [and] seek no administrative or other penalties against the Respondents based on the evidence in this case,” CPSD reserves the right to provide information to, or to cooperate with, law enforcement agencies, courts of law or other federal or state administrative

(xi) is otherwise Misleading in a material respect.” (Winback Consent Decree, pp. 5-6.)

¹⁶ As the Winback Consent Decree notes, \$1.2 million was also the maximum amount of the forfeiture that could have been imposed on respondents if their conduct had been found to constitute willful or repeated violations of § 201(b) of the Telecommunications Act, 47 U.S.C. § 201(b). *Compare*, Winback Consent Decree, ¶¶3 and 10.

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agencies in any investigation relating to the issues here. (§§5.6, 5.7.) If the Commission wishes to modify any provision in the settlement agreement, all parties have 15 days within which to file a written objection to the proposed modification, and if that objection is not withdrawn within 10 days thereafter, the settlement will be deemed rescinded, and the respondents will be entitled to the return of any settlement funds they have already paid. (§§7.3, 1.4.)¹⁷

Finally, enforcement and breach are the subject of several provisions in the agreement. §5.1 provides that “each material breach of this Settlement will constitute a separate violation and will entitle the Commission to take any necessary action to enforce its orders.” Similarly, although CPSD has agreed not to initiate enforcement actions or seek penalties against the respondents based on the facts of this case, this limitation “will not apply if the Respondents jointly or severally materially breach this Settlement or violate the Commission order approving it.” (§5.6.)

Discussion

Rule 51.1(e) requires that before any settlement can be approved, the Commission must find that it is reasonable in light of the whole record, consistent with law, and in the public interest. With modifications to some terms, we think the proposed settlement agreement here can meet these tests.

The most attractive aspects of the proposed settlement are that (1) it requires respondents to pay \$2.95 million, part of which is for restitution, and

¹⁷ The parties have also agreed to request that “in the decision approving this Settlement, the Commission should order full cooperation from the pertinent Billing Agents, Underlying Facilities Based Providers, LECs, and any other Persons or Corporations subject to the jurisdiction of the Commission that are necessary to implement this Settlement.” (§5.9.)

(2) it requires respondents to abide by the terms of the Call Unit Marketing and Sales Compliance Program included in the FCC TCU Consent Decree. Taken together, these two features should serve to ensure that respondents will not be tempted to engage in the marketing abuses alleged in both the OII and in the Notice of Apparent Liability for Forfeiture that led to the FCC TCU Consent Decree.

In their joint motion for approval of the settlement, CPSD and respondents have argued that under our prior decisions, the \$2.95 million settlement payment satisfies the requirement of Rule 51.1(e) that a settlement be consistent with law. The parties note that while the Pub. Util. Code §§ 2107 and 2108 provide for substantial fines (ranging from \$500 to \$20,000 per day in the case of continuing violations), the Commission has held that “no nexus is required between the settlement payments and any wrong alleged in the case,” because “settlement payments are made in compromise and in lieu of the penalty amounts specified in Sections 2107-2108.” (Joint Motion at 4-5, citing D.00-09-034, *In re Southern California Gas Co.*, *mimeo.* at 28.) In light of the total amount of the settlement (which amounts to about \$2,100 for each customer who submitted a complaint to the CAB), we find the settlement sum to be reasonable in light of the whole record and consistent with legal requirements.

As noted above, another attractive feature of the settlement is that the 1400 customers who complained to CAB will receive some restitution. Although the total amount of restitution is not large in relation to the total settlement (\$35,000 out of \$2.95 million), the \$25 restitution check that each Eligible Consumer will be entitled to receive is consistent with the amounts of restitution we have approved in other telecommunications enforcement proceedings, and that we have found to be consistent with the public interest. *See, Investigation of Long Distance Charges, Inc.*, D.02-06-075, *mimeo.* at 14-15; *Investigation of Coleman*

Enterprises, Inc., D.00-12-050, *mimeo.* at 12-14; *Investigation of Brittan Communications International Corp.*, D.98-04-024, *mimeo.* at 5; *Investigation of L.D. Services, Inc.*, D.97-11-079, *mimeo.* at 2-3; *Investigation of Heartline Communications, Inc.*, D.96-12-031, 69 CPUC2d 584, 591 (1996).

The third reason we believe this settlement is reasonable and should be approved (subject to the modifications described below) is that, in the words of the Joint Motion, the settlement will “save[] the Commission significant expenses and use of its resources, when compared to the risk, expense, complexity and likely duration of further proceedings.” (Joint Motion at 3, citing *In re Southern California Gas Co.*, *mimeo.* at 18-20.) In their joint motion for approval, CPSD and respondents argue that conservation of Commission resources will be achieved here because, “while a hearing in this case could have possibly resulted in a larger payment and/or restitution, such results are far from certain and could only be achieved at great expense to Staff resources and time.” (Joint Motion at 3.) The parties note that evidentiary hearings would have required at least a week, with CPSD alone presenting 11 to 15 witnesses. Further, in the event of an adverse decision, the respondents could have been expected to file an application for rehearing pursuant to Pub. Util. Code § 1731 and then to seek review in the California Court of Appeal. Given this litigation risk and potential for delay, we agree with the moving parties that—with the addition of the changes specified below—the proposed settlement is reasonable.

Although the amount of the settlement payment, the provision for restitution, and the respondents’ agreement to abide by the Call Unit Marketing and Sales Compliance Program in the FCC TCU Consent Decree all make for an attractive settlement package, we are concerned about ¶¶1.4 and 7.3 of the settlement agreement. Read together, these provisions would require *all* payments made by respondents to be returned to them in the event the

settlement agreement is rescinded or the decision approving it is vacated.¹⁸

Although this provision is tolerable in connection with the \$2.9 million in settlement payments the Commission will be remitting to the General Fund, it is not acceptable in connection with the \$50,000 that respondents will be paying for the purpose of restitution.

Although unlikely, it is at least theoretically possible that rescission of the settlement agreement or vacation of the approving decision could occur *after* the payment of restitution has begun. In such a case, it would be unreasonable to expect CPSD or the Commission to contact Eligible Consumers and ask them to return their restitution checks, or to cover Rosenthal's fee out of Commission funds. As a condition of approving the settlement, we will therefore require the parties to modify ¶¶1.4 and 7.3 to make clear that neither CPSD nor the Commission will have any obligation to return the \$50,000 once the restitution process (including Rosenthal's preparatory work) has begun.

We will also require two other changes in the settlement agreement relating to payments. First, Appendix A to the settlement—the fee agreement between respondents and Rosenthal—should be modified to make clear that Rosenthal's fee shall not exceed \$7,825. Second, ¶5.1 of the settlement agreement

¹⁸ Although the settlement agreement is not crystal clear on this point, it appears that the parties' intent is that either CPSD or the respondents may rescind the settlement within the timeframes specified in ¶7.3 if one of them cannot accept a change ordered by the Commission. However, once the agreement goes into effect, its terms must be performed unless the decision approving the settlement is vacated by the Commission. *Compare*, ¶¶1.4, 5.6, and 7.3. Assuming this is the parties' intent, the agreement should be clarified by including a reference to ¶7.3 wherever rescission is mentioned (*e.g.*, "rescission within the time periods set forth in ¶7.3.") We do not consider acceptable any arrangement allowing the respondents to rescind the settlement agreement once it has been approved and gone into effect.

should be amended to make clear that any failure by the respondents to make settlement payments in the amounts and on the schedule provided for in ¶1.3 shall constitute a material breach of the settlement agreement.

Another provision in the settlement agreement that causes us concern is ¶5.10, which requires CPSD to withdraw its protest of A.01-12-013, the Blue Ridge application, within 30 days after a Commission decision approving the settlement. On the first page of the settlement agreement, the parties state their intent is that “the Commission agrees” that after this withdrawal, the Commission will “resolve A.01-12-013 as an unopposed application.”

The Draft Decision (DD) that was mailed to the parties on April 6, 2004 expressed reluctance to accept this term if, as seemed to be the case, it meant that the parties sought to foreclose the Commission from conducting any further inquiry into the fitness of the individuals who control Blue Ridge, at least two of whom (Messrs. Arnau and Koppy) were also named as individual respondents in the OII. After quoting the language about resolving Blue Ridge as an unopposed application, the DD stated:

“[T]his language might be read as somehow obliging us in our consideration of A.01-12-013 to ignore the facts that (1) this OII and the proceeding that resulted in the FCC TCU Consent Decree have taken place, and (2) two of Blue Ridge’s principals, Michael Arnau and Joseph Koppy, are also among the persons who control the respondents. It would be unreasonable to ignore these facts, especially in view of the allegations in the Winback Order to Show Cause and the terms in the Winback Consent Decree that the respondents have accepted in order to settle that proceeding with the FCC.” (DD, p. 21, footnotes omitted.)

Rather than accept the parties’ agreement on the Blue Ridge application, the DD required that as a condition for acceptance of the settlement agreement, Blue Ridge would be required to submit, within 45 days after the Commission

decision approving the settlement, a supplement to A.01-12-013. The supplement was to include an update setting forth the status of the litigation mentioned in the OII in I.02-05-001, as well as a certification that “as of the date of the [update], no investigation, administrative proceeding, or litigation has been commenced against, or directed at, Blue Ridge, NOS, ANI, or any of their respective affiliates in connection with the provision of local exchange service.” If respondents could not give such a certification, they were instructed to furnish “full details” regarding any litigation, investigation or administrative proceeding brought against or directed at them in connection with their local exchange service. The DD also provided that if the ALJ was “dissatisfied with the supplement in any respect, he or she may require that it be corrected, amended or supplemented further.”

In the comments they filed on April 26, 2004, the respondents objected to these requirements, saying that they constituted a material change in what respondents had bargained for, and would lead to rescission of the settlement agreement pursuant to ¶7.3 thereof. Respondents’ comments stated:

“The [DD] sharply deviates from the parties’ expectations regarding this provision of the agreement . . . Although the [DD] does permit CPSD to withdraw its protest to the Blue Ridge application, it posits treating A.01-12-013 as ‘unopposed’ in name only. It imposes on Respondents a series of additional requirements which include reporting any pending litigation against Respondents referred to in CPSD’s soon-to-be-withdrawn protest, as well as any litigation against Respondents in connection with the provision of local exchange service.

“As written, the [DD] fails to provide for resolution of the Blue Ridge application as an ‘unopposed application,’ as that term is well understood by the parties and others . . . By so doing, the [DD] calls into question the resolution and uncontested status for which

Respondent[s] specifically bargained.” (Respondents’ Comments, pp. 2-3.)

Although we will permit CPSD to withdraw its protest of A.01-12-013, we place both CPSD and Blue Ridge (which is a party to this proceeding)¹⁹ on notice that we cannot accept the term in the settlement agreement that explicitly ties the settlement of I.02-05-001 to the Commission’s agreement -- which CPSD is not free to give -- to grant A.01-12-013 on an unopposed basis.²⁰ In keeping with this conclusion, we will require Blue Ridge to file a supplement to A.01-12-013 within 30 days after the effective date of this decision. In this supplement, Blue Ridge shall certify that as of the date of the filing, no investigation, administrative proceeding, or litigation has been commenced against, or directed at, Blue Ridge, NOS, ANI, or any of their respective affiliates in connection with the provision or marketing of local exchange service. If Blue Ridge cannot give such a certification, it shall provide full details (including docket numbers) regarding any investigation, administrative proceeding, or litigation that has been brought

¹⁹ Blue Ridge was designated as a party to this proceeding in D.02-07-045, the order in which the Commission denied rehearing of the OII.

²⁰ The relevant paragraph appears on page one of the settlement agreement under the heading “Summary/Joint Statement of the Case” and provides in full:

“The Parties by themselves or their authorized representative(s) agree to and accept the Terms and Conditions stated below. In express reliance on such acceptance, as well as the covenants and representations stated therein, the Commission agrees to end its investigation and close the docket in I.02-05-001 and to resolve A.01-12-013 as an unopposed application. Upon approval by the Commission, this Settlement will release the Respondents from and constitute a final settlement of any and all costs, claims or causes of action, direct or indirect, presently known or unknown, accruing to or incurred by the Commission during the course of investigation and review in this proceeding.”

against or directed at Blue Ridge, NOS, ANI, or any of their respective affiliates in connection with the provision or marketing of local exchange service. If the ALJ assigned to A.01-12-013 is dissatisfied with the supplement in any respect, he or she shall have full discretion to require that the supplement be corrected or amended, or that a hearing be held to take evidence on the fitness of the applicants in A.01-12-013 to receive a CPCN to provide resold facilities-based local exchange service.²¹

²¹ Thus, we reject respondents' suggestion in their April 26, 2004 comments that as an alternative to the supplement of the Blue Ridge application required by the DD, we should accept a form of certification that their counsel attached to the April 26 comments. Respondents contended that this alternative approach provided the same information contemplated by the DD, and that after reviewing it, the Commission should grant the CPCN requested in A.01-12-013 in the same order approving the settlement agreement in I.02-05-001.

In the revised DD posted on the Commission's website on May 5, 2004, the assigned ALJ concluded that the form of certification accompanying the April 26 comments was unacceptable, principally because the declaration of counsel that served to verify the status report attached to the comments covered only *litigation* against the respondents and their affiliates in connection with the provision of local exchange service, and did not address *investigations* or *administrative proceedings* covering local exchange service, as the DD had contemplated.

After reaching the ALJ by telephone late in the day on May 5, respondents' counsel sought to submit an amended declaration addressing these concerns. In the amended declaration, counsel stated that "after making . . . inquiry, I state that to the best of my knowledge no litigation, investigation or administrative proceeding has been brought, or is pending, against or related to Blue Ridge, NOS Communications, Inc., Affinity Network, Inc. or any affiliate or dba of any of them in connection with the provision of local exchange services."

Although the amended declaration, unlike its predecessor, tracks the language on page 22 of the DD, we still believe that it is insufficient to justify granting A.01-12-013 without further inquiry. First, to the extent it is intended as a verification, the amended declaration does not meet the requirements for verifications set forth in Rule 2.4(b) of our Rules of Practice and Procedure. Second, the declaration was signed by counsel

Footnote continued on next page

As noted above, ¶5.10 of the settlement agreement also requires CPSD not to “protest an application filed by Respondents or any of their affiliates pursuant to [Pub. Util. Code] Sections 851-854, 1001, or 1013 based on the investigation or allegations in this matter.” While this term is not unreasonable *per se*, its effect could be unreasonable if, in any application for transfer of control or other authority covered by the cited Code sections, the Commission were not made aware of the fact that the application involved a party to this proceeding. Accordingly, as a condition of approving the settlement agreement here, we will require that in any application filed by NOS, ANI, Blue Ridge, or any of their respective affiliates pursuant to Pub. Util. Code §§ 851-854, 1001, or 1013, the applicant(s) must disclose (1) the fact that I.02-05-001 was filed, (2) that I.02-05-001 has been settled pursuant to the settlement agreement approved herein, and (3) the relationship of the applicant to this proceeding.

Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7. Opening comments

rather than an officer or general partner of the respondents, even though (1) one of respondents’ officers or general partners was presumably available by telephone, and (2) the use of facsimile signatures is permitted if the requirements of Rules 2.2(e) and 2.5(b) are met. Third, the amended declaration may contain an ambiguity, inasmuch as it is not clear whether its language is intended to cover litigation, administrative proceedings or investigations concerning respondents’ *marketing* of local exchange services, although such marketing was clearly one of the focuses of the discussion on page 22 of the DD. Finally, the amended declaration has not been submitted for filing to our Docket Office.

For all of these reasons, we conclude that the CPCN requested in A.01-12-013 should not be granted in this order, but should instead be granted only after the ALJ assigned to that proceeding has had an adequate opportunity to develop the record on the fitness of the Blue Ridge applicants.

were filed by the respondents on April 26, 2004, and reply comments were filed by CPSD on April 30, 2004. The “Discussion” section of this decision has been revised to reflect these comments.

Assignment of Proceeding

Geoffrey F. Brown is the Assigned Commissioner and A. Kirk McKenzie is the assigned ALJ in this proceeding.

Findings of Fact

1. In D.02-07-045, the Commission denied rehearing of the OII herein, but modified the OII to make clear that Blue Ridge is a party to this proceeding.
2. The settlement agreement appended hereto as Attachment A is unopposed.
3. The proposed settlement will achieve customer restitution, because approximately 1400 Eligible Consumers will each receive a restitution payment of \$25, for a total of \$35,000.
4. The restitution payments described in the preceding finding are consistent with those in other settlements the Commission has approved in recent years for telecommunications customers allegedly victimized by deceptive marketing, cramming, and slamming.
5. The proposed settlement will help to protect the public from unscrupulous marketing practices by telecommunications carriers, will serve to obtain refunds for customers allegedly injured by respondents’ actions, and will help to promote a robust telecommunications market free from unfair competition.

Conclusions of Law

1. The proposed restitution payments described in Finding of Fact 3 are reasonable.

2. The proposed fee of \$7,825 to be paid to Rosenthal under the settlement agreement for its services as settlement claims administrator acting in a fiduciary capacity for Eligible Consumers is reasonable.

3. The \$2,900,000 that respondents have agreed to pay to the Commission to settle this proceeding, in addition to the restitution to be paid to Eligible Consumers, is reasonable and lawful under the statutes and Commission decisions discussed in this opinion.

4. The provision in the settlement agreement requiring respondents to abide by the Call Unit Marketing and Sales Compliance Program included in the FCC TCU Consent Decree, for a period of two years following the Commission's decision approving the settlement agreement, is reasonable.

5. The draft fee agreement attached to the settlement agreement as Appendix A should be modified to provide that the fee paid to Rosenthal as legal claims administrator shall not exceed \$7,825.

6. The settlement agreement should be modified to make clear that the right to rescind the agreement provided for in ¶¶1.4 and 7.3 thereof may be exercised only within the time periods specified in ¶7.3. This modification does not affect the right of respondents to seek the return of payments (other than payments intended for restitution) in the event that the decision approving the settlement agreement is vacated by the Commission for reasons other than a material breach thereof.

7. The settlement agreement should be modified to provide that once the restitution process (including preparatory work by Rosenthal) has begun, neither the Commission nor CPSD will have any obligation for any reason to return to respondents the \$50,000 payment intended for restitution purposes, as described in ¶1.2.1 of the settlement agreement.

8. ¶5.10 of the settlement agreement should be modified to provide that in any application filed by any of the respondents herein or their affiliates pursuant to Pub. Util. Code §§ 851-854, 1001, or 1013, the applicant(s) shall disclose (a) the fact that this proceeding was filed, (b) the fact that this proceeding was settled pursuant to the settlement agreement approved herein, and (c) the relationship between the applicant and this proceeding.

9. Blue Ridge should be required to file, within 30 days after the issuance of this decision, a supplement to A.01-12-013. The supplement should contain Blue Ridge's certification, if such a certification can be given, that as of the date of the supplement, no investigation, administrative proceeding, or litigation has been commenced against or directed at Blue Ridge, NOS, ANI, or any of their respective affiliates, in connection with the provision or marketing of local exchange service.

10. In the event that Blue Ridge cannot give the certification required by Conclusion of Law (COL) 9, the supplement filed by Blue Ridge should provide full details (including docket numbers) regarding any investigation, administrative proceeding, or litigation that has been brought against or directed at Blue Ridge, NOS, ANI, or any of their respective affiliates, in connection with the provision or marketing of local exchange service.

11. The ALJ assigned to A.01-12-013 should have discretion to require that the supplement required by COL 9 be amended or corrected, or that a hearing be held on said application.

12. The settlement agreement should be modified to provide that any failure by the respondents to make settlement payments in the amounts and on the schedule provided for in ¶1.3 of the settlement agreement shall constitute a material breach of the agreement.

13. With the modifications described in COLs 5-12, the settlement proposed herein is reasonable in light of the whole record, consistent with law, and in the public interest.

14. With the modifications described in COLs 5-12, the settlement agreement described herein should be approved.

15. Today's order should be made effective immediately.

FINAL ORDER

IT IS ORDERED that:

1. Subject to the modifications required by Conclusions of Law 5-12, the settlement agreement appended to this decision as Attachment A is approved.

2. All billing agents, facilities-based providers, local exchange carriers, and all other persons and corporations subject to the jurisdiction of this Commission that provide services or facilities of any kind to any one or more of the respondents in this proceeding, shall cooperate fully in carrying out the provisions of the settlement agreement approved herein.

3. Within 45 days after the issuance date of this decision, the respondents shall execute the fee agreement with Rosenthal & Company LLC referenced in paragraph 2.1 of the settlement agreement approved herein, and shall make the payment specified in paragraph 1.2.1 thereof.

4. Application 01-12-013 remains open for further consideration, as described in the foregoing opinion, findings of fact, and Conclusions of Law.

5. Investigation 02-05-001 is closed.

This order is effective today.

Dated June 9, 2004, at San Francisco, California.

MICHAEL R. PEEVEY

President

CARL W. WOOD

LORETTA M. LYNCH

GEOFFREY F. BROWN

SUSAN P. KENNEDY

Commissioners

ATTACHMENT A

ALL PARTIES' SETTLEMENT AGREEMENT

(END OF ATTACHMENT A)

[Appendix to I0205001/A0112013 McKenzie](#)